

**Review of Special Projects in the
New Jersey District Collection Division**

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for TAX
ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

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MEMORANDUM FOR COMMISSIONER ROSSOTTI

FROM: Lawrence W. Rogers /s/Lawrence W. Rogers
Acting Treasury Inspector General for Tax Administration

SUBJECT: Final Audit Report - Review of Special Projects in the
New Jersey District Collection Division

This report presents the results of our review of special projects in the New Jersey District Collection Division. In summary, we found that special projects were used to help the New Jersey District Collection Division achieve statistical goals, while resulting in mistreatment of taxpayers. During our audit, the Acting District Director suspended activity on all Collection Division special projects. All special projects in the New Jersey District Collection Division have now been closed. The Assistant Inspector General for Investigations is conducting inquiries into some of the findings included in this report.

To strengthen the use of special projects in a manner consistent with both sound tax administration and concern for taxpayers, we recommend that the District Director approve all levy and seizure actions on special project cases. We also recommend that Collection management certify that all legal and procedural requirements are met prior to seizure or levy. Management should also ensure that: enforcement actions taken on special project cases are consistent with enforcement actions taken on non-project cases; special projects have a sound basis for initiation; and projects are properly re-authorized when there are changes in objectives, scope, or project duration. Finally, projects should be adequately documented, and District Counsel should review and approve all locally developed notices used on special projects.

Your response to a draft of this report discusses several corrective actions, planned or previously implemented, that will improve the reported conditions.

We have included your comments in the report where appropriate, and the full text of your reply is included as Appendix IV.

Copies of this report are also being sent to the Internal Revenue Service managers who are affected by the report recommendations. Please call me at (202) 622-6500 if you have any questions, or your staff may contact Maurice S. Moody, Acting Assistant Inspector General for Audit, at (202) 622-8500.

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Executive Summary

In Fiscal Year (FY) 1998, two national audits were performed in the New Jersey Collection Division. One review focused on the use of Collection performance measures and statistics. The other review focused on the use of seizure authority in the Collection Field function. In each of these reviews, facts developed from the District's Liquor License Project (LLP) contributed to audit findings. Based on a sample of seizures from 11 districts, 50% of the legal defect and contact cases presented in the report on seizures were attributable in part to practices on the LLP. These practices did not conform to the notice and contact requirements that are designed to protect taxpayers' rights.

This audit was initiated to determine whether special projects in the New Jersey District Collection Division were initiated, controlled and executed to ensure project objectives were achieved while ensuring taxpayers' rights were protected.

Results

Special projects were used to help the Collection Division meet statistical goals while resulting in mistreatment of taxpayers. During our audit, in July 1998, the Acting District Director suspended activity on all Collection Division special projects.

We found the following, warranting management attention:

- The Department of Labor (DOL) Project was used to issue levies on 8,000 taxpayers with management instructions not to attempt initial contact with the taxpayers. Revenue officers were also instructed to initiate levy actions without ensuring a Notice of Intent to Levy had been issued or performing initial case analysis. These practices were intended to meet a divisional goal of closing approximately 3,400 cases in a relatively short timeframe, prior to the close of an evaluation period for the District. The DOL Project case closures significantly contributed to the achievement of the District's *Average Hours per Entity Disposition* goal. These practices do not conform to Service procedural requirements, and increase the risk of failure to meet legal notification requirements. A preliminary review of these levies showed instances where wage levies were issued on taxpayers who were deceased, had financial or medical hardships, or were not liable for the tax.
- Levying as the first action on a case, as occurred in the DOL Project, appeared to be an established practice in the New Jersey District and was used as a means to expeditiously close taxpayer cases. This is not a sound business practice and is contrary to Service procedural requirements. Taxpayers' rights are not protected when the Service fails to contact taxpayers prior to taking levy actions or to perform

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initial analysis to determine if legal notice requirements have been met. During our audit, the Acting Chief, Collection Division issued revised levy procedures to all Collection Division employees.

- We will fully assess and report the impact of this practice in a separate report on the District's use of levy authority.
- The LLP was used to seize liquor licenses over a 28-month period, which significantly increased seizure statistics for the District. Over 500 seizures were conducted during this period. In FY 1997, the New Jersey District led the nation in the number of seizures conducted, and at least 28% of the seizures were on LLP cases. The number of seizures was included in national, regional and local Collection activity reports. Seizure numbers from the LLP were also regularly provided to the District Director in monthly briefings.
- Our review did not identify evidence that the LLP was initiated for the *primary purpose* of increasing the number of seizures. However, the project was initiated with the knowledge that seizure statistics would increase, as supported by statements from the District's Collection Division FedState Coordinator. Early LLP meeting minutes indicate that the District intended to seize licenses and considered noncompliance in the liquor license market segment as egregious. Project plans called for seizing a liquor license if the license was in jeopardy (i.e., the State plans to seize the liquor license or the taxpayer attempts to dispose of assets). However, our review of LLP seizures in a previous review determined that liquor license seizures were not conducted using jeopardy procedures. A comparison of data from LLP seizures and non-LLP seizures raises questions regarding the propriety of using seizure actions to achieve voluntary compliance for this taxpayer group. In our opinion, the LLP became a vehicle to attain seizures.

We found other conditions warranting management attention as follows:

- Management did not always have an empirical basis for initiating projects.
- Special projects were not properly re-authorized when there were changes to the scope, life or completion date.
- Locally developed collection notices issued to taxpayers on the LLP were inappropriately patterned after a Notice of Intent to Levy, and documentation requirements for the project were not met.

Summary of Recommendations

The Internal Revenue Service (IRS) has a legitimate need to assist taxpayers in voluntarily meeting their tax obligations by tailoring efforts to the needs of market groups, as well as

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developing methods to enforce payment when other alternatives are unsuccessful. Special projects, when used appropriately, are intended to be a vehicle to accomplish this. By adopting our recommendations, the District can strengthen the use of these projects in a manner consistent with both sound tax administration and concern for taxpayer needs.

1. Require District Director approval for all levy and seizure actions on special project cases. This would supplement the Service requirement for Director approval of all seizures of residences, perishable goods, and household goods.
2. To assist in this approval process, require Collection management certification that all legal and procedural requirements have been met before a request is forwarded for approval. A comprehensive check sheet for seizures, developed in response to Office of Audit's report on the use of seizure authority, could be used in the certification process for levy actions as well as seizures.
3. Ensure that enforcement actions taken on special project cases are consistent with enforcement actions taken on non-project cases with regard to frequency and case circumstances. To accomplish this, consider using Service employees who are independent of the New Jersey Collection Division to conduct reviews at appropriate intervals.
4. Require District Counsel approval for all locally developed taxpayer notices used on special projects to ensure that all legal requirements are met.
5. Ensure that all documentation requirements are met for special projects to provide a clear trail of all actions taken for subsequent review.
6. Ensure that a sound business basis, supported by reliable data, exists for initiating projects.
7. Ensure that special projects are re-authorized by the Director when there are changes in objectives, scope, or project duration.

Management's Response

All special projects in the New Jersey Collection Division have ended. Revised review and approval procedures have been instituted regarding all District seizure actions and training will be used to stress the need for prudent use of levies as an enforcement tool.

IRS stated that the District has no plans to develop any local taxpayer notices; if, however, this is done in the future, the District will submit them for District Counsel approval. The District will establish review and oversight procedures, and procedures regarding documentation requirements for all future special projects. District Office Research and Analysis (DORA) will be used to secure sound empirical data to support all future projects.

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The District will follow the Compliance Initiative Project (CIP) guidelines and requirements to ensure proper initiation and re-authorization of all special projects when changes occur.

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Objective and Scope

The objective of this audit was to determine whether special projects in the New Jersey District Collection Division were initiated, controlled and executed to ensure that project objectives were achieved while ensuring taxpayers' rights were protected.

To accomplish our objective, we:

- Evaluated management's basis for initiating special projects.
- Determined if special projects were properly initiated, controlled and monitored.
- Determined if special projects delivered desired outcomes.
- Determined whether special projects were initiated and worked in a manner that ensures taxpayers' rights were adequately protected.

The objective of this audit was to determine if special projects in the New Jersey District were initiated and executed in a manner that ensured project objectives were achieved and taxpayers' rights were protected.

In carrying out the scope of work, we:

- Interviewed management in national, regional, and local offices.
- Obtained and analyzed project documentation.
- Reviewed results from prior internal audits.

In particular, we reviewed the following six projects initiated from January 1992 to January 1997: Department of Labor (DOL), Liquor License, Attorneys, Certified Public Accountants/Public Accountants, Construction and Healthcare. We conducted our review from May through September 1998 in accordance with generally accepted government auditing standards. See Appendix I for detailed information on the objective, scope and methodology of this review. Appendix II contains a listing of major contributors to this report.

Review of Special Projects in the New Jersey District Collection Division

Background

In Fiscal Year (FY) 1998, Internal Audit (now the Office of Audit, Treasury Inspector General for Tax Administration) performed two national reviews in the New Jersey Collection Division. One review focused on the use of Collection performance measures and statistics in establishing goals, driving program achievement, and evaluating accomplishments at the program and individual levels. The other review focused on the use of seizure authority in the Collection Field function.

In each of these reviews, facts developed from the New Jersey District Liquor License Project (LLP) contributed to audit findings. For example, we reported that information from feeder reports used to capture various enforcement statistics (dollars collected, number of levies, number of liens, and number of seizures) was accumulated and used to rank revenue officers. In addition, a memorandum from the District Fedstate Coordinator to New Jersey District Collection Division group managers involved in the LLP, suggested that these statistical measures, coupled with limited case reviews, would be used to recommend revenue officers' continuance on the project.

Facts developed from the New Jersey District Liquor License Project contributed to findings in two previous national audits.

Findings presented in the review of the use of seizure authority identified several issues relating to seizures occurring in the LLP. Fifty percent of the legal defect and contact cases found on that audit were attributable in part, to the practices used on the LLP. These practices did not conform to the notice and contact requirements designed to protect taxpayers' rights.

The FY 1994 Strategic Business Plan (SBP) outlined the Compliance 2000 strategy designed to proactively assist taxpayers in voluntarily meeting their tax obligations. Compliance 2000 was conceived to tailor efforts to the needs of diverse groups with common tax-related characteristics such as small businesses, the self-

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employed, those in a particular occupation, or those who speak a language other than English. By September 30, 1998, most of the compliance workload, including education and assistance efforts, was to aim at specific compliance issues based on market segment analysis.

Between January 1992 and January 1997, the New Jersey District initiated several projects aimed at specific market segmentation issues.

In response to the Compliance 2000 strategy, the New Jersey District Collection Division initiated several market segmentation projects. These projects focused on the following market segments: attorneys, Certified Public Accountants/Public Accountants, construction, healthcare, and liquor license holders. An additional project focused on obtaining levy sources using New Jersey DOL data.

In FY 1997, the Compliance Best Practices Forum recognized one of these special projects, the LLP, as a national best practice. The purpose of the Compliance Best Practices Forum is to share exceptional, proven practices that have improved the way the Service does business by increasing compliance and/or reducing taxpayer burden.

Our audit focused on the Liquor License and DOL Projects because they affected the greatest number of taxpayers and the other projects had less activity.

We focused on the DOL Project because it affected over 8,000 taxpayers. We focused on the LLP because of the findings presented in the prior national audit report on the use of seizure authority. We also focused more of our efforts on the LLP since management considers it the most successful special project. According to Collection reports, about \$18.7 million has been collected from the start of the LLP in March 1996 through June 12, 1998. The LLP is also one of the Collection market segment special projects that the District has measured to determine its impact on voluntary compliance.

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Results

Special projects were used to help the Collection Division achieve statistical goals while resulting in mistreatment of taxpayers.

Special projects were used to help Collection meet statistical goals while resulting in mistreatment of taxpayers. The DOL Project was used to issue wage levies on 8,000 taxpayers with management instructions not to attempt initial contact with the taxpayers. Revenue officers were also instructed to initiate levy actions without sending a Notice of Intent to Levy or performing initial case analysis.

These practices were intended to meet a divisional goal of closing approximately 3,400 cases in a relatively short timeframe, prior to the close of an evaluation period for the District. These practices do not follow Service procedures, and they increase the risk of failure to meet legal notification requirements. A preliminary review of these levies showed instances where wage levies were issued on taxpayers who were deceased, had financial or medical hardships, or were not liable for the tax. Levying as a first action appeared to be an established practice in the New Jersey District prior to this audit (see page 13). We will fully assess and report on the impact of this practice in a separate report on levy actions.

The LLP was used to seize liquor licenses over a 28-month period, which significantly increased seizure statistics for the District. The number of seizures was included in national, regional and local Collection activity reports. Seizure numbers from the LLP were also regularly provided to the District Director in monthly Collection Division briefings.

We did not identify any evidence that the LLP was initiated for the *primary purpose* of increasing the number of seizures. However, the project was initiated with the knowledge that seizure statistics would increase. Early LLP meeting minutes indicate that the District intended to seize licenses and considered noncompliance in the liquor license market segment as egregious. Project plans called for seizing a liquor license if the

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license was in jeopardy (i.e., the State plans to seize the liquor license or the taxpayer attempts to dispose of assets). However, Office of Audit's review of LLP seizures on a previous audit showed that liquor license seizures were not conducted under jeopardy procedures. Accordingly, we conclude that the LLP became a vehicle to attain seizures.

The LLP resulted in over 500 seizures from its start in March 1996 through June 12, 1998. Seizures in the New Jersey District rose from 235 in FY 1995, to 422 in FY 1996, and to 945 in FY 1997. In FY 1997, New Jersey District led the nation in the number of seizures conducted. FY 1997 New Jersey District seizures accounted for about 9% of all seizures nationwide (945 of 10,090 seizures). At least 28% of the FY 1997 New Jersey District seizures (253 of 945) were on liquor license cases.

LLP seizures resulted from the firm enforcement approach Collection took when working this market segment. In addition to the firm enforcement approach, measuring the success and progress of the LLP was of great significance.

Special projects did not always have a sound empirical basis, were not always properly re-authorized, and used specially developed notices inappropriately patterned after a Notice of Intent to Levy.

We also found other conditions warranting attention as follows:

- Management did not always have a sound empirical basis for initiating special projects (see page 9).
- Special projects were not properly re-authorized when there were changes to the scope, life or completion date (see page 11).
- Special notices developed for the LLP were inappropriately patterned after a Notice of Intent to Levy, and documentation requirements were not met (see page 15).

In July 1998, the Acting District Director suspended activity on all Collection Division special projects.

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**Special projects were used to achieve
statistical goals.**

Department of Labor Project

The DOL Project was used to help the New Jersey District achieve statistical measures. In FY 1997, the District was given goals designed to promote improvements in timeliness and efficiency. These FY 1997 goals were part of a two-year plan to bring New Jersey's timeliness and efficiency indicators in line with regional norms.

*The New Jersey District
Collection Division used the
DOL Project to assist in
achieving statistical goals.*

According to FY 1998 planning documents dated May 1997, the District was failing to meet its goal on *Average Hours per Entity Disposition*. The District ranked last in the region in this measure by a substantial degree. It was noted that the District had certain special projects underway which they hoped would mitigate the efficiency shortcomings. The planning document concluded, however, that special projects are no substitute for an efficient regular program.

Three months later, the August 20, 1997, Collection Division Monthly Briefing reported that the *Average Hours per Entity Disposition* dropped from 44.1 through May, to 39.3 through June to 37.7 through July. In March 1997, the monthly briefing indicated the DOL Project would enable the District to make the goal of 39. Per that briefing, the District would need between 2,200 and 3,300 entity dispositions to meet the goal.

In a March 27, 1997, memorandum the Chief, Collection Division requested that Field Branch Chiefs stay sufficiently involved with the DOL cases to ensure the Division meets its objective of closing 3,400 cases. Levies and/or Letters 1058 (Notice of Intent to Levy) were to be issued by April 4, 1997, and all levies served by May 6, 1997.

The DOL Project case closures significantly contributed to the achievement of the *Average Hours per Entity Disposition* goal of 39. In our opinion, management

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instructions to eliminate procedures requiring initial case analysis prior to levy contributed to the low average 4.9 hours per disposition for DOL Project cases. The District Director recognized the Chief, Collection Division, for attaining this goal.

Liquor License Project

The New Jersey District ranked number one in the nation in the number of seizures performed in FY 1997. In FY 1997, New Jersey District conducted 945 seizures. Seizures in the New Jersey District accounted for about 9% of all seizures nationwide (945 of 10,090).

The LLP resulted in at least 28% of the New Jersey District's total seizures for FY 1997 as a result of the firm enforcement approach the District employed.

Seizure numbers from the LLP were regularly provided to the District Director in monthly Collection Division briefings. At least 28% of the FY 1997 New Jersey District seizures (253 of 945) were on liquor license cases. This was a result of the firm enforcement approach Collection took when working this market segment.

Although we did not find definitive evidence that the project was initiated for the *primary purpose* of increasing the number of seizures, the project was initiated with the knowledge that seizure statistics would increase. The FedState Coordinator stated that the basis for the LLP was to bring taxpayers into compliance. The Coordinator added that he knew the LLP would bring in seizures since the liquor license existed as an asset. The basis for initiating a project in the District is to come up with a technique to address a particular industry, e.g., bars/restaurants that have liquor licenses as assets.

Early LLP meeting minutes indicate that the Collection Division informed the New Jersey Division of Taxation that the District intended to take expedient enforcement action on LLP cases, including seizure action on licenses and other assets. LLP meeting minutes also state that "...egregious taxpayer cases require swift and decisive case actions (seizure action)."

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The District considered noncompliance in the liquor license market segment as egregious and intended to take expedient enforcement action on these cases.

The District considered noncompliance in the liquor license market segment as egregious. For example, in the October 1997 Monthly FedState Briefing, it was reported that "A 'consistent and fair' collection approach on the egregious cases has resulted in 486 liquor license seizures." As recorded in LLP meeting minutes, revenue officers were told to use prompt assessment procedures on IRC § 6020(b) cases.

Project plans called for seizing a liquor license if the license was in jeopardy. However, a previous national audit determined that LLP seizures were conducted without using jeopardy procedures.

In the prior national review of the use of seizure authority, we sampled 150 seizures conducted in the New Jersey District during FY 1997. We analyzed data collected from that sample. We compared data on LLP seizures with information on other seizures. Thirty-seven of 150 seizures in the sample were part of the LLP. The results of our analysis are presented in the chart below.

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Category	LLP Seizures	Other Seizures
<i>Average Liability</i>	\$21,120	\$159,485
<i>Average Sale Proceeds</i>	\$892	\$10,006
<i>Average Redemption Proceeds</i>	\$10,760	\$18,447
<i>Average Release Proceeds</i>	\$1,716	\$4,519
<i>Average RWMS Score¹</i>	20,849	72,482

Figure 1 Comparison of Liquor License Project and non-Liquor License Project seizures

The above data raise questions about the propriety of using seizures to achieve voluntary compliance for this taxpayer group. Although not all-inclusive, the data further support our conclusion that the LLP became a vehicle to improve seizure statistics for the District.

Basis for initiation

Two of the six projects we reviewed lacked an empirical basis for initiation.

Two of the six projects we reviewed lacked an empirical basis for initiation. The basis for initiating the DOL Project was to secure additional wage levy sources for *uncooperative* and delinquent taxpayers. However, no analysis was performed to determine the level of taxpayer cooperation. The basis for initiating the Certified Public Accountant/Public Accountant (CPA/PA) project was to address noncompliance among a highly visible market segment. However, the specified purpose of the project lacked empirical support.

¹ RWMS stands for the Resource and Workload Management System. RWMS scores accounts based on the potential yield and assigns the score at the time of Taxpayer Delinquent Account (TDA) or Taxpayer Delinquency Investigation (TDI) issuance. The higher the RWMS score, the higher the potential yield.

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The basis for the Liquor License Project could have been better substantiated.

In addition, the basis for another project could have been better substantiated. We reviewed the justification for establishing the LLP and determined that:

- The New Jersey Division of Taxation, not the Collection Division, selected the sample of liquor licenses used to determine the noncompliance rate and justify the project.
- The sample included two duplicate entities, which resulted in overstating the noncompliance rate in the liquor license market segment.
- The sample included two social clubs, which were excluded from the project.

Our review of the LLP determined that it was established to address compliance on a market segment basis and was included as an annual operating plan action item. For example, the FY 1994 Mid-Atlantic Regional Annual Operating Plan (RAOP) included an action item for the region to reduce the payroll tax deposit problems in at least one market segment by working jointly with external stakeholders to identify the causes and implement solutions. The region intended to look into the liquor license market segment to fulfill this action item.

As part of fulfilling the FY 1994 RAOP action item, Collection and District Counsel met with the New Jersey Division of Taxation and the New Jersey Alcohol Beverage Commission in March 1994. The purpose of the meeting was to explore the potential for jointly sponsored tax clearance legislation similar to that passed in Hawaii and South Carolina. Preliminary indications were that legislative changes to the current law would be difficult. The District planned to look into developing a database to identify this market segment.

The FY 1996 Northeast RAOP included an action item to conduct research to identify compliance and tax administration issues by market segment to develop comprehensive strategies to improve compliance. Collection reported that it was extremely proactive in

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this area, citing the LLP, CPA/PA, Attorney and Construction Projects.

Information Gathering Projects

Until February 1998, market segment projects were initiated using Information Gathering Project (IGP) procedures. IGP procedures were designed for Examination Division's use to identify areas of non-compliance. Since IGP procedures were not Collection-based, management did not have specific guidance for Collection Division special projects.

Because IGP procedures lacked cross-functional guidance, new Compliance Initiative Project (CIP) guidelines have been developed. CIP procedures combined and replaced the separate procedures for IGPs, Compliance 2000 projects, Returns Compliance Programs (RCPs), and other special projects. CIP procedures are designed to be cross-functional and provide guidance for all compliance initiatives.

All of the six special projects we reviewed had the required approvals for initiation.

Five of the six special projects we reviewed had the required approval for initiation as IGPs. The other special project was classified a FedState initiative and also had the appropriate approvals. According to the requirements, IGPs must be approved by the District Director using Form 6545, Information Gathering Project Authorization.

Four of six special projects were not timely re-authorized, as required.

However, special projects were not properly re-authorized, as required, when there were changes to the scope, life or completion date. Four of six special projects we reviewed were not timely re-authorized when there was a change in the estimated completion date.

Form 6545 also includes a justification for an IGP. According to the joint Collection and Examination Form 6545 for the LLP, the purpose of the project was to determine filing compliance and work with the Examination Division to develop a gross profit markup method to verify reported gross receipts.

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We determined that Collection did not work jointly with the Examination Division as planned. For example, Collection and Examination did not conduct joint field visits. In addition, the Examination Division established its own IGP for the liquor license market segment.

The original joint Collection and Examination IGP was authorized on February 1, 1995, with an estimated completion date of June 30, 1996. On June 7, 1996, the District Director approved an extension through June 30, 1997, as requested by the Chief, Collection Division. On January 22, 1997, the Acting District Director approved an extension for the Examination Division through December 31, 1997. The Collection Division did not get a corresponding extension, nor was the project extended into 1998.

*New Jersey District
management did not establish
an RCP for the LLP nonfiler
leads.*

In addition to re-authorization issues, management did not establish an RCP for the LLP nonfiler leads. This was noted in the recently completed peer review of the New Jersey District Collection Division. The peer review concluded that the District should have established an RCP.

Management believed that the IGP was adequate approval to work the nonfiler leads from the LLP and that a separate RCP was not necessary. However, management should have established an RCP.

Management's use of the RCP time code indicates that the nonfiler portion of the LLP should have been classified as an RCP. We found that from March through November 1996, approximately 17,000 hours were charged using the RCP time code for the LLP.

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Special projects did not always comply with established procedures and sound business practices.

Levy as a First Action

On August 26, 1998, we issued a memorandum to the District Director informing him that revenue officers in the New Jersey District Collection Division were instructed to take levy action on approximately 8,000 DOL Project cases without attempting initial contact with taxpayers. The DOL Project was designed to identify additional levy sources. Taxpayers' rights are not adequately protected when the Service does not attempt to contact taxpayers prior to taking levy actions.

A levy is an administrative means to enforce collection of taxes. Enforcement is an important element of an effective compliance program. Revenue officers should determine appropriate case actions, including enforcement, based on the facts of each case. The Investigation and Analysis job element requires a revenue officer to proceed in a logical manner to secure, verify, and analyze information that will lead to a prompt and proper case resolution.

An effective initial contact, which includes verification of the liability, payments made, and the ability of the taxpayer to pay the full liability, is the cornerstone of timely and effective case resolution. Service guidelines require revenue officers to make an initial contact on all taxpayer cases either by a telephone call or a field visit. The goal of the initial contact is to bring the taxpayer into full compliance with all filing and payment requirements.

Revenue officers were instructed to initiate levy actions without sending a Notice of Intent to Levy or performing initial analyses on those cases.

New Jersey District revenue officers were instructed to give priority attention to issuing levies on DOL Project cases. Revenue officers were also instructed to initiate levy actions without sending a Notice of Intent to Levy or performing initial analyses on those cases. This practice was observed in an effort to meet a divisional goal of closing approximately 3,400 cases in a relatively

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short timeframe, prior to the close of an evaluation period for the District.

Levying as a first action appears to be an established practice in the New Jersey District Collection Division as a means to expeditiously close taxpayer cases. This is not a sound business practice. Without initial telephone or field contacts, revenue officers cannot ensure that taxpayers are aware of their rights prior to the issuance of levies. Without initial case analysis, revenue officers cannot determine if final notices have been mailed and if taxpayers have been informed about the collection process. When cases are not processed according to guidelines, taxpayers may be subject to additional burden and the embarrassment of levy action. Additionally, the District faces the increased risk of issuing improper levies.

In our memorandum, we recommended that the New Jersey District Collection Division discontinue the practice of levying as a first action without performing initial analysis on each case and ensuring that a Notice of Intent to Levy has been issued.

In response to our concerns, the Acting Chief, Collection Division issued revised levy procedures to all Collection employees. According to the revised procedures, "Effective immediately, levy action will not be the first action taken on a case..." with limited exceptions based upon managerial review and approval. We will fully assess and report the impact of this issue in a separate report on levy actions.

Special notices

Special notices were issued to 1,125 taxpayers as part of the LLP. Regional Counsel examined samples of these notices and concluded that the notices were a variation of a Notice of Intent to Levy, and did not meet the legal requirement for the Notice of Levy in Section 6331 of the Internal Revenue Code (IRC) because they did not allow the taxpayer 30 days notice before levy.

The LLP used specially developed notices inappropriately patterned after a Notice of Intent to Levy.

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According to Collection management, the special notice was never intended to be a Notice of Intent to Levy. The intent of the letter was to give taxpayers another opportunity to respond prior to Collection taking action.

Since it was never intended to be a Notice of Intent to Levy, the special notice was not issued in accordance with the requirements of the IRC. The special notice was issued with a 10-day response time and was not sent via certified mail. The IRC requires that Notices of Intent to Levy be sent at least 30 days prior to levy action. No less than 30 days before the day of the levy, a Notice of Intent to Levy must be sent via certified or registered mail to a taxpayer's last known address, given in person, or left at a taxpayer's dwelling or usual place of business.

The special notices issued to the LLP taxpayers were not reviewed by District Counsel or the District Director prior to issuance. However, there is no requirement for a formal review of locally developed notices prior to their issuance.

Taxpayers in the LLP may have received erroneous notices.

As a result, taxpayers receiving this special notice who had not previously received a legally valid Notice of Intent to Levy would have been threatened with an illegal seizure. As of June 1998, the District reported over 500 LLP seizures. A previous audit on the use of seizure authority determined that in 17 of 37 LLP seizures sampled, the District did not adhere to legal requirements. In addition, because the LLP included taxpayer delinquency investigation cases, these taxpayers may have received erroneous notices.

Project documentation

LLP case files were not adequately documented.

Copies of special notices sent out on LLP cases were not included in Collection case files. There is no record on the Integrated Data Retrieval System (IDRS) or on the Integrated Collection System (ICS) that these letters were issued. In addition, Collection management and District Office Research and Analysis could not provide us with the files used to generate the special notices. Therefore, we could not determine which tax periods and

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corresponding balances due were included on the attachments to those notices.

All transactions and significant events in the Collection Division should be clearly documented. The documentation should be readily available for examination and should be accurate and complete. The documentation should facilitate tracing transactions and events after they are completed.

Management did not maintain adequate control over the diskettes and files used to generate the special notices. Several employees had custody of the files and copies of the letters were not printed for the case files.

Without documentation of the special letters, the Service will not have a complete record of actions taken and employees may be lacking a vital piece of information regarding taxpayer accounts.

Without documentation for the special notices, the Service will not have a complete record of actions taken on taxpayer accounts. In addition, without copies of the notices in taxpayer files or a record of the correspondence on automated systems such as IDRS and ICS, employees not directly knowledgeable of special notices may be lacking a vital piece of information when subsequently working on those taxpayer accounts.

Recommendations

Management should take the following actions to improve the use of special projects in the New Jersey District Collection Division and to ensure that both taxpayers' and the Service's rights and interests are protected.

1. Require Director approval for all levy and seizure actions on special project cases. This would supplement the Service requirement for Director approval of all seizures of residences, perishable goods, and household goods.

Management's Response: Revised review and approval procedures have been instituted regarding all District seizure actions. All special projects in the New Jersey Collection Division have ended. Training has been instituted to stress the need for prudent use of levies as an enforcement tool.

Review of Special Projects in the New Jersey District Collection Division

Collection Division previously issued a memorandum regarding levy activity on all cases.

2. Require Collection management certification that all legal and procedural requirements have been met before a special project seizure or levy request is forwarded for approval. A comprehensive check sheet for seizures, developed in response to Office of Audit's report on the Use of Seizure Authority, could be used in the certification process for levy actions as well as seizures.

Management's Response: The District issued a memorandum that established the process designed to comply with National Office instructions, and the comprehensive seizure checksheet must accompany all seizure approval requests. The approval process was expanded to include Special Procedures function review, prior to submission to Division.

3. Ensure that enforcement actions taken on special project cases are consistent with enforcement actions taken on non-project cases with regard to frequency and case circumstances. Consider using reviewers independent of the New Jersey Collection Division to conduct the reviews at appropriate intervals.

Management's Response: Project activities have been ended on all Collection Division special projects. Review and approval procedures have been instituted regarding seizure actions, and the District issued a memorandum on March 6, 1998, establishing the process designed to comply with National Office instructions.

4. Require District Counsel approval for all locally developed taxpayer notices used on special projects to ensure that all legal requirements are met.

Management's Response: The District has no plans to develop any local taxpayer notices; if, however, this is done in the future, the District will submit them for District Counsel approval.

Review of Special Projects in the New Jersey District Collection Division

5. Ensure that all documentation requirements are met for special projects to provide a clear trail of all actions taken for subsequent review.

Management's Response: The District will establish review and oversight procedures, and procedures regarding documentation requirements for all future special projects.

6. Ensure that a sound business basis, supported by reliable data, exists for initiating special projects.

Management's Response: The District will continue to work with the DORA staff to secure sound empirical data to support all future proposed special projects.

7. Ensure special projects are re-authorized by the Director when there are changes in objectives, scope, or project duration.

Management's Response: The District now follows the CIP guidelines and requirements to ensure proper initial and re-authorization of all special projects when any changes occur.

Conclusion

The Service has a legitimate need to assist taxpayers in voluntarily meeting their tax obligations by tailoring efforts to the needs of market segments, as well as developing methods to enforce payment when other alternatives are unsuccessful. Special projects, when used appropriately, are intended to be a vehicle to accomplish this. By adopting our recommendations, the District can strengthen the use of these projects in a manner consistent with both sound tax administration and concern for taxpayer needs.

Detailed Objective, Scope and Methodology

Our overall objective was to determine whether New Jersey District special projects were initiated, controlled and executed to ensure that project objectives were achieved while ensuring taxpayers' rights were protected. To achieve this objective we:

- I. Evaluated management's basis for initiating special projects based on specific taxpayer groups or market segments.
 - A. Interviewed local management and determined the basis for initiating a project in the liquor license industry and identified all steps taken for initiating the project.
 - B. Obtained and reviewed planning documents to identify procedures used for initiating special projects.
 - C. Evaluated the justification for initiating special projects to ensure there was sufficient and reliable evidence to document the lack of compliance in the targeted group.
 - D. Identified the goals and objectives of special projects and determined if expected results and benefits to the function and the Service were stated.
- II. Determined if special projects were properly initiated, controlled and monitored.
 - A. Interviewed National and Regional Office management and determined oversight, policies and guidelines implemented to assist districts in initiating local projects.
 - B. Determined if National Office implemented new initiatives in the FedState program relative to the Business Licensing Strategy or database matching.
 - C. Identified approving officials for special projects and determined if the approvals were in accordance with guidelines.
 - D. Interviewed Collection Division management and approving officials and determined if steps taken to initiate special projects were in compliance with procedures.
 - E. Determined whether project inventories were established in accordance with rules, policies and procedures.
- III. Determined whether special projects achieved desired outcomes.
 - A. Obtained and analyzed closed case data from ICS for a sample of special project cases to determine the impact of project results.

**Review of Special Projects in the
New Jersey District Collection Division**

- B. Identified other functions/agencies involved in the Collection special project efforts and determined if goals were worthwhile and achieved.
 - C. Compared Liquor License Project (LLP) seizures with other seizures to determine if seizures for LLP cases were comparable to non-LLP seizures.
 - D. Obtained and analyzed available information on the floorteam concept.
- IV. Determined whether special projects are handled in a manner that ensures taxpayers' rights are adequately protected.
- A. Assessed background information to determine whether the projects were initiated with procedures that would foster infringement of taxpayers' rights.
 - B. Obtained Regional Counsel opinions on notices developed for special projects.
 - C. Obtained and reviewed prior Office of Audit results.

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Appendix III

Report Distribution List

Chief Operations Officer OP

Regional Commissioner, Northeast Region RC

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Office of Management Controls M:CFO:A:M

Review of Special Projects in the New Jersey District Collection Division

Appendix IV

Management's Response



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

February 26, 1999



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MEMORANDUM FOR ACTING TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

FROM: Charles O. Rossotti
Commissioner of Internal Revenue

SUBJECT: Draft Internal Audit Report - Review of Special Projects in the
New Jersey District Collection Division

I am troubled by the findings in this report, as well as the National audit on the use of seizure authority in the Collection field function. Both reports identified violations of Internal Revenue Code (IRC) and Internal Revenue Manual (IRM) requirements that are designed to protect taxpayer rights. As I have stated previously, the abuse of even one taxpayer is one too many.

As a result, I launched a management review of seizures and sales that is being headed by John Layton, Disciplinary Action Review Project Director. This review will address Servicewide management of seizures from group level to the National Office, including program and operational guidance provided by National, Regional, and District managers, approval processes, the adequacy of managerial review of each transaction, and the role of higher levels of management in reviewing the seizure program. The review was started in January with an expected completion date of 2 to 3 months.

In addition to the Servicewide management review, our comments on the specific recommendations in this report follows.

Recommendation 1: Require district director approval for all levy and seizure actions on special project cases. This would supplement the Service requirement for director approval of all seizures of residences, perishable goods, and household goods.

Assessment of Cause: Project revenue officers were authorized to sign and issue levies. Front line managers were the sole source for seizure action review and approval.

Corrective Actions: (Note: All special projects in the New Jersey Collection Division have been closed.)

Review of Special Projects in the New Jersey District Collection Division

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1a. Revised review and approval procedures have been instituted regarding all district seizure actions. The district issued a memorandum on March 6, 1998, that established the process designed to comply with National Office instructions.

1b. Revenue officers will continue to be empowered to issue levies per the Internal Revenue Manual. Training has been instituted to stress the need for prudent use of this enforcement tool. The training takes the form of both taxpayer rights awareness training, and Restructuring and Reform Act of 1998 (RRA 98) training.

1c. The Collection Division issued specific instructions via memorandum regarding levy activity on all cases in the district's inventory.

Implementation Dates:

1a. Completed: March 6, 1998

1b. Completed: February 1, 1999

1c. Completed: July 13, 1998

Responsible Official: District Director, New Jersey District

Recommendation 2: Management should require Collection management certification that all legal and procedural requirements have been met before a special project seizure or levy request is forwarded for approval. A comprehensive checklist for seizures could be used in the certification process for levy actions as well as seizures.

Assessment of Cause: Project revenue officers were authorized to sign and issue levies. Front line managers were the sole source for seizure action review and approval.

Corrective Actions:

2a. Revised review and approval procedures have been instituted regarding all district seizure actions. The district issued a memorandum that established the process designed to comply with National Office instructions and RRA 98 regulations. The district developed a comprehensive seizure checklist, based on the Internal Revenue Manual and RRA 98 regulations, which must accompany all seizure approval requests. The approval process was expanded to include Special Procedures function review, prior to submission to division.

2b. The Collection Division issued specific instructions via memorandum regarding levy activity on all cases in the district's inventory.

Review of Special Projects in the New Jersey District Collection Division

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Implementation Dates:

2a. Completed: March 6, 1998

2b. Completed: July 13, 1998

Responsible Official: District Director, New Jersey District

Recommendation 3: Management needs to ensure that enforcement actions taken on special project cases are consistent with enforcement actions taken on nonproject cases with regard to frequency and case circumstances. Consider utilizing reviewers independent of the New Jersey Collection Division to conduct the reviews at appropriate intervals.

Assessment of Cause: Front line project managers did not consistently exercise thorough oversight regarding project cases and enforcement activity on those cases. In addition, front line general program managers did not consistently review and oversee collection activity on project cases.

Corrective Actions: All special projects have been closed. Procedures have been implemented that will eliminate the impression of disparate treatment for special project cases.

3a. Project activities have ended on all Collection Division special projects.

3b. Revised review and approval procedures have been instituted regarding all district seizure actions. The district issued a memorandum on March 6, 1998, that established the process designed to comply with National Office instructions.

Implementation Dates:

3a. Completed: July 31, 1998

3b. Completed: March 6, 1998

Responsible Official: District Director, New Jersey District

Recommendation 4: Management needs to ensure that all locally developed taxpayer special project notices are reviewed and approved by District Counsel prior to issuance.

Assessment of Cause: Procedures and guidelines were not established regarding the need for District Counsel review and approval of locally developed taxpayer notices for district cases (project or nonproject).

Review of Special Projects in the New Jersey District Collection Division

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Corrective Action:

4a: The district has no plans to develop any local taxpayer notices; if, however, this is done in the future, the district will submit them for District Counsel approval.

Implementation Date: 4a. Completed: January 1, 1999

Responsible Official: District Director, New Jersey District

Recommendation 5: Management needs to ensure that all documentation requirements are met for special projects to provide a clear trail of all actions taken for subsequent review.

Assessment of Cause: Management review guidelines regarding project case documentation were not fully established and provided to the employees. In addition, all transactions regarding significant activities in the special projects were not clearly documented.

Corrective Action:

5a. Management will establish review and oversight procedures, and procedures regarding documentation requirements for all future special projects.

Implementation Date: 5a. Proposed: March 1, 1999

Responsible Official: District Director, New Jersey District

Recommendation 6: Management needs to ensure that a sound business basis, supported by reliable data, exists for initiating projects.

Assessment of Cause: Internal Audit found that special projects did not always comply with established procedures and sound business practices.

Corrective Action:

6a. The district will continue to work in concert with local District Office Research and Analysis staff to secure sound empirical data to support all future proposed special projects.

Implementation Date: 6a. Completed: November 17, 1998

Review of Special Projects in the New Jersey District Collection Division

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Responsible Official: District Director, New Jersey District

Recommendation 7: Management needs to ensure that special projects are re-authorized by the director when there are changes in objectives, scope, or project duration.

Assessment of Cause: At the time these special projects were worked in the New Jersey District, the guidance available regarding special projects was geared toward Examination Division special projects.

Corrective Action:

7a. Beginning in May 1998, the district began to follow the Compliance Initiative Project (CIP) guidelines, and requirements to ensure proper initial and reauthorization of all special projects when any changes occur. Note that the CIP guidelines are somewhat generic as they are intended for use by different functions. However, Collection staff recently worked with Examination and Research staff to include any necessary Collection-specific guidelines in the upcoming revision of the CIP guidelines.

Implementation Date: **7a.** Completed: May 30, 1998

Responsible Official: District Director, New Jersey District